Risk Management

Good risk management does not imply avoiding all risks at all cost. It means making well-informed decisions regarding the risks we want to take in pursuit of our goals and the measures to mitigate those risks. We design our risk management policies, not as an isolated add-on process, but as embedded in our strategy design and execution.

To integrate the risk dimension fully in our strategy design, we identify how much risk we are willing to take, and how we want to balance risks and opportunities. Our ability to perform this tight balancing act is an essential element of our Enterprise Risk Management (ERM).

Our risks arise in the areas of deposit taking, lending, securities investment and trading, foreign exchange and operational support. Our risk appetite is defined by a set of qualitative standards and quantitative metrics aimed at maintaining strong capital and liquidity position, stable funding, good risk-reward balance, acceptable business practices and dynamic compliance culture. Our risk metrics allow us to monitor our risk exposure under normal and stressed scenarios against established trigger levels and limits. Predefined approval hierarchy and escalation processes apply during breach of our risk limits. Reports on the Bank's risk profile are presented to the senior management and the Board of Directors. These are all contained in the Board-approved risk manuals. These are revisited on an annual basis, or more frequently based on the changing risk environment and evolving regulatory landscape.

In 2018, the Bank transitioned to using Philippine Financial Reporting Standards 9 (PFRS 9) compliant models to meet the requirements set forth under BSP Circular No. 912 and 1011. These mandated all Philippine banks to adopt a forward-looking expected credit loss (ECL) model approach in measuring credit impairment. In response to these, the Bank created quantitative models through statistical, economic, financial and mathematical techniques to calculate credit impairment provisions. Policies and governance over the new models were formulated. These were implemented effective January 1, 2018.

Furthermore, the Bank has also complied with the requirements under BSP Circular No. 981 on the "Guidelines on Liquidity Risk Management," BSP Circular No. 982 on the "Enhanced Guidelines on Information Security Management," and BSP Circular No. 1021 on the "Guidelines on Marking to Market of Financial Instruments."

Risk management structure

Our Board of Directors takes the lead on all major risk management initiatives. It approves broad strategies and policies, and ensures that these are consistent with our overall objectives.

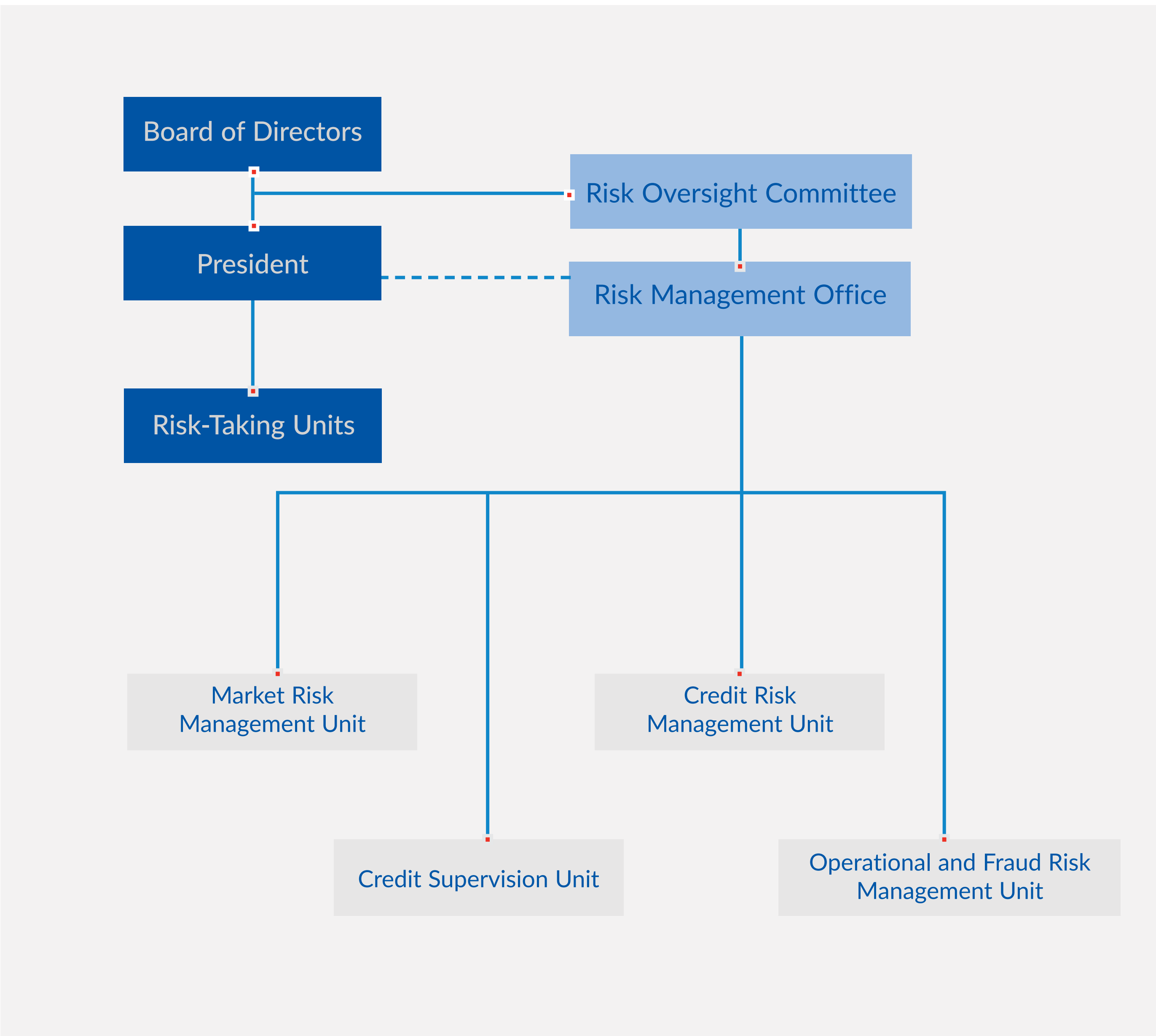
The Risk Oversight Committee (ROC) is comprised of at least three members of the Board, the majority of whom are independent directors including its Chairperson. Its Chairperson is not the Chairperson of the Board or of any other committee. The ROC members possess expertise and knowledge of the Bank's risk exposures, which enable them to develop appropriate strategies for preventing or minimizing the impact of losses.

The Board may also appoint non-Directors to the ROC as part of the Metrobank Group's risk oversight measures. However, only Bank Directors shall be considered as voting members. Non-voting members are appointed in an advisory capacity.

The ROC oversees our Enterprise Risk Management (ERM) framework, the consistency of current and emerging risk exposures with our strategic direction and overall risk appetite and the effectiveness of our risk management function in monitoring our risk-taking activities. It formulates policies and strategies to identify, measure, manage and limit risks. The ROC ensures that the system of limits approved by the Board remains effective. It also makes certain that limits are observed and that immediate corrective actions are taken whenever needed.

The Risk Management Office (RMO), together with the President, various committees and management, support the ROC in the fulfillment of its duties and responsibilities.

The RMO is independent from executive functions and business line responsibilities, operations and revenue-generating functions. It reports directly to the Board through the ROC. Below is the Bank's Risk Organization:



The RMO supports the ROC in carrying out its responsibilities by:

- Analyzing, communicating, implementing and maintaining the risk management policies approved by the ROC and the Board;
- Spearheading the regular review of the Bank's risk management policies and elevating recommendations that enhance the risk management process to the ROC and the Board, for their approval;
- Ensuring that the risks arising from the Bank's activities are identified, measured, analyzed, reported and understood by risk takers, management, and the Board. It analyzes limit exceptions and recommends enhancements to the limits structure;
- Monitoring the risk exposures and determining the corresponding capital requirement in accordance with the Basel III capital adequacy framework and based on the Bank's internal capital adequacy assessment on an ongoing basis;
- Monitoring and assessing decisions to accept particular risks whether these are consistent with Board-approved policies on risk tolerance and appetite as well as the effectiveness of the corresponding risk mitigation measures; and
- Reporting on a regular basis to Senior Management and the Board the results of assessment and monitoring.

Types of Risks

The Bank's posture towards its risks is described below.

Credit Risk

This is the risk in which a counterparty fails to meet its contractual obligations. The Bank has low tolerance for non-performing loans. To ensure this, our lending business follows credit policy guidelines set by the Board, ROC, and RMO. These guidelines serve as our minimum standards for extending credit. Everyone engaged in the credit process are required to understand and adhere to these policies.

Our product manuals contain business plans and define the business parameters by which credit activity is to be performed. Before extending a loan, we observe a system of checks and balances, including the approval of at least two credit approvers through the Credit Committee (Crecom), Executive Committee (Excom), or the Board.

The ROC reviews our business strategies and ensures that revenue-generating activities are within the Bank's overall risk appetite and meet the Board-approved credit risk thresholds.

We hold regular audit across our organization. The Board — through the Excom, Crecom, and ROC — ensures that all business segments follow sound credit policies and practices.

We assess the portfolio growth and health using key performance indicators. We manage risk concentrations by type of individual or group of borrowers, by geographical region, and by industry sector. We measure the credit quality of financial assets using our internal loan loss models. We use credit scoring models and decision systems for consumer loans, and borrower risk rating and facility risk rating models for SME loans, as approved by the Board.

We carry out stress testing analyses using Board-approved statistical models, relating the default trends to macroeconomic indicators.

Credit Concentration Risk

Risk concentration is managed by type of individual or group of borrowers, by geographical region, and by industry sector. These are closely monitored with sufficient senior level oversight to ensure that the Bank's low risk tolerance and policies for risk concentration are enforced.

The Bank computes for additional risk weighted asset attributed to credit concentration following the methodology of the Metrobank Risk Group. Concentration risk is scoped in two dimensions: name (or concentration due to specific obligors) and industry (or concentration due to specific industries).

Market Risk

This covers the areas of trading, interest rate, and liquidity risks. Trading market risk is the risk to earnings and capital arising from changes in the value of traded portfolios of financial instruments. Interest rate risk arises from movements in interest rates. Liquidity risk is the inability to meet obligations when they fall due without incurring unacceptable losses.

Our market risk policies and implementing guidelines are regularly reviewed by the Assets and Liabilities Committee (ALCO), ROC and the Board to ensure that these are up-to-date, in accordance with the Bank's low appetite for market risks, and in line with changes in the economy, environment and regulations. The ROC and the Board set a comprehensive market risk limit structure and define the parameters of market activities that the Bank can engage in. We utilize various measurement and monitoring tools to ensure that risk-taking activities are managed within instituted market risk parameters.

Trading Market Risk

Our trading portfolios are currently composed of peso and dollar-denominated debt securities that are marked-to-market daily. We use Value-at-Risk (VaR), a statistical measure that calculates the maximum potential loss from a portfolio over a holding period, within a given confidence level. Our current VaR model is based on a historical simulation methodology with a one- day holding period and a 99% confidence level.

We also perform back testing to validate the VaR model, and stress testing to determine the impact of extreme market movements on our portfolios. We establish limits for trading portfolios and closely monitor our daily profit and loss against loss triggers and stop-loss limits. These ensure that the Bank's trading activities are in line with its low tolerance for market risk.

To a certain degree, we also carry foreign exchange (FX) risk. It is our policy to maintain exposures within approved position limits, stop loss limits, loss trigger, VaR limits and to remain within regulatory standards. We also use VaR to measure market risk arising from our FX exposure. We use BSP-approved Type 3 Derivative License for plain vanilla FX forwards to manage our FX risk against adverse exchange rate movements.

Structural Interest Rate Risk

The interest rate sensitivity gap report measures interest rate risk by identifying gaps between assets and liabilities by repricing period. Our sensitivity gap model calculates the effect of possible rate movements on its interest rate profile.

We use the sensitivity gap model to estimate our Earnings-At- Risk (EAR) should interest rates move against our interest rate profile. The EAR is capped by limits based on a percentage of our projected earnings and capital for the year.

We also perform stress testing analysis to measure the impact of various scenarios based on interest rate volatility and shifts in the yield curve.

The ALCO is responsible for managing our structural interest rate exposure. Its goal is to achieve a desired overall interest rate profile within the Bank's low appetite for interest rate risk and keeping flexibility to interest rate movements and changes in economic conditions. RMO and ROC review and oversee our interest rate risks.

Liquidity Risk

In managing our liquidity position, we ensure that we have more than adequate funds to meet maturing obligations. We use the Maximum Cumulative Outflow (MCO) model to measure liquidity risk arising from the mismatches of our assets and liabilities.

We administer stress testing to assess our funding needs and strategies under different conditions. Stress testing enables us to gauge our capacity to withstand both temporary and long-term liquidity disruptions. Our Liquidity Contingency Funding Plan (LCFP) helps us anticipate a liquidity crisis under various stress scenarios. Liquidity limits for normal conditions cap the outflows on a cumulative and per tenor basis.

We discourage dependence on Large Funds Providers (LFPs) and monitor our deposit funding concentrations versus our High Quality Liquid Assets (HQLA). This way, we will not be vulnerable to a substantial drop in deposit level should there be an outflow of large deposits. ALCO is responsible for managing our liquidity while RMO and ROC review and oversee our overall liquidity risk management.

The Bank has zero appetite for non-compliance with liquidity requirements and ensures this through the close monitoring and management of its High Quality Liquid Assets vis-a-vis its net cash outflows.

Operational Risk

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. To mitigate these and meet the Bank's standard for low tolerance of operational risks, we constantly strive to maintain our strong "control culture," prudently use technology and adopt an effective internal control system. These we consider as key factors in our continuous self-improvement under a "no- surprise" operating environment.

Our Board-approved, bank-wide organizational chart clearly establishes areas of management responsibility, accountability and reporting lines for all senior officers. Operational risk management policies and frameworks are regularly reviewed and updated, subject to ROC and Board approvals to ensure that they remain relevant and effective.

Our products and operating manuals, policies and procedures spell out internal controls implemented by our business and operating support units. Our Internal Audit Group (IAG) provides independent reasonable assurance on control adequacy and compliance with these manuals. We identify and assess operational risks across the organization and develop controls to mitigate and manage them as part of our continuing efforts to enhance our Operational Risk Management Framework. We perform this vis-a-vis the Board-approved operational loss thresholds and benchmarks.

To ensure that we manage all operational risks adequately, specialized functions are engaged in risk management. These include: Information Technology and Quality Assurance, Information Security, Financial Control, Legal, Compliance, Human Resources and Security Command. IAG regularly reports to the Board's Audit Committee on the effectiveness of internal controls.

We likewise implement a Business Continuity Plan and a Disaster Recovery Program that are reviewed and tested annually on a per segment and bank-wide basis to ensure their effectiveness in case of business disruptions, system failures and disasters.

Technology Risk

Technology risk is the risk to earnings or capital arising from deficiencies in systems design, implementation, maintenance of systems or equipment and the failure to establish adequate security measures, contingency plans, testing and auditing standards.

We invest in information technology to provide simpler, faster, more convenient and secured banking services to our growing clientele. We also utilize an advanced management information system that enables us to make fast and well-informed business decisions. We continuously venture into core business process automations, key system enhancements, and information security solutions while ensuring we meet the Bank's low appetite for technology risks.

Given the heavily automated operating environment, we ensure that we identify and quantify risks to the greatest extent possible. We also establish standards and controls to manage technology-associated risks through effective planning, proper implementation, periodic measurement and monitoring of performance.

Legal Risk

Legal risk is the potential loss due to nonexistent, incomplete, incorrect, and unenforceable documentation that we use to protect and enforce our rights under contracts and obligations. The Bank has low tolerance for legal risks and employs legal review process to control and manage these risks. The Legal Department performs this function and ensures, that contracts, documentation and activities adequately protect our interests and comply with applicable legal and regulatory requirements.

Regulatory Risk

Regulatory risk, also known as compliance risk, covers the potential loss from non-compliance with laws, rules and regulations, policies and procedures, and ethical standards.

We recognize that compliance risk can diminish our reputation, reduce our franchise value, limit business opportunities, and reduce our potential for expansion. Thus, guided by our Compliance Office, we continuously promote a culture of compliance to support the Bank's low appetite for regulatory risk.

Strategic Risk

Strategic risk is the current and prospective impact on earnings or capital arising from adverse business decisions, improper resolution of conflicts, and slow response to industry changes.

Strategic risk can shape our long-term goals, business strategies, and resources. Thus, we utilize both tangible and intangible resources to carry out our business strategies and meet the Bank's low appetite for Strategic Risk. These include communication channels, operating systems, delivery networks, and managerial capacities and capabilities.

Reputational Risk

Reputational risk is the current and prospective impact on earnings or capital arising from negative public opinion. This affects our ability to establish new relationships or services, or manage existing relationships. The risk may also expose us to litigation, financial loss, or a decline in customer base.

All are responsible for building our brand reputation and exercising an abundance of caution when dealing with customers and communities to support the Bank's zero tolerance for reputational risk.

For a complete discussion of PSBank's capital details, please refer to the Supplementary Management Discussion and Notes to the Financial Statements on Financial Risk Management Policies and Objectives.